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The state budget: California never cut up credit card despite pledges by the governor, system wasn't fixed and another deficit looms

By Greg Lucas
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"Cut up the credit card" has been Arnold Schwarzenegger's fiscal mantra since before he was elected governor in October 2003.

What constitutes cutting up the credit card is in the eye of the cardholder, but traditionally the process involves scissors, resulting in the termination of spending money one doesn't have.

This is what the GOP governor said it meant in his January 2004 State of the State speech shortly after taking office.

"When individuals overspend themselves into trouble, financial counselors often tell them to consolidate their credit card balances so they can work their way out of trouble, and also tear up their credit cards."

The \$15 billion bond approved by voters in March of that year to pay down California's persistent gap between spending commitments and revenue collections was the same kind of consolidation, Schwarzenegger said.

"We tore up the credit card," Schwarzenegger said. "Never again will government be allowed to spend money it doesn't have. Never again will the state be allowed to borrow money to pay for its operating expenses."

Even with the debt consolidation, ugly spending cuts would be required to erase what Schwarzenegger predicted was another \$15 billion shortfall for the state's fiscal year beginning in July 2004.

Spending cuts were necessary because tax increases would only worsen California's economy and retard job creation, the governor and his GOP allies insisted.

"Irresponsible" budgeting by the Legislature and his Democratic predecessor over the previous five years had created a "financial house of cards ... set to collapse," Schwarzenegger said of the combination of borrowing, fee increases and spending cuts enacted to help close a staggering \$38.2 billion shortfall.

Fast forward to January 2008.

The governor will present his fifth State of the State speech. He is certain to devote part of the talk to how he plans to deal with what he says is a \$14 billion gap between money coming in and the cost of government services.

He has already said he will declare a fiscal emergency to get the Legislature to cut spending sooner because a cut saves more the sooner it's made. The situation is dire enough that he is contemplating reducing spending on public schools by \$1.5 billion this year and another \$1.5 billion next year.

"We're anywhere between \$10 (billion) and \$14 billion in the hole when it comes to the budget," Schwarzenegger said at a recent Long Beach news conference. "This is a common thing for California, that we're going on this rollercoaster ride. What we have to do is fix the budget system. The system itself needs to be fixed, and I think this is a good year, this coming year, to fix it."

Isn't it supposed to be fixed?

California consolidated its debt. It snipped the credit card into itsy little bits back in 2004. How can there possibly be a \$14 billion fiscal emergency?

Because, as it is with so many holiday shoppers, the credit card is still very much in use.

It's convenient. Politics is the art of the possible, and the Republican governor has to make deals with a Democratic-controlled Legislature.

Predictably, the GOP governor is kicked by the right and the left for running up the state's charge card despite the fact that neither side has either the temperament or political muscle to bring the state's finances into balance.

"Rather than make good on fixing the state's fiscal problems, he has broken his promise," rails the Standing Up for California Web site created by Phil Angelides, the man Schwarzenegger bested to win re-election in 2006. "Now California's debt stands at a staggering \$25 billion. And it's growing every day!"

Grumbles Sen. Tom McClintock, ostensibly a player on the team the governor quarterbacks:

"He's dramatically increased both the short-term and the long-term debt of this state. He's been running massive budget deficits and therefore using borrowed money to repay borrowed money which doesn't get you very far."

At a 2005 meeting with The Chronicle's editorial board, when asked whether there was a gap between his actions and his campaign rhetoric, Schwarzenegger replied, "I said when I came into office that I would slowly take care of the problem. I made it very clear it could not be done in one year."

To his credit, so to speak, Schwarzenegger has used only \$11.3 billion of the \$15 billion in budget-balancing bonds and has expedited repayment of them. He led the charge for a Proposition 1A, which restricts the ability to borrow revenue earmarked for transportation projects and use it to balance the general fund.

"There are a lot of things we have done over the years to improve the state's fiscal condition although we still have a challenge ahead of us," said H.D. Palmer, spokesman for Schwarzenegger's Department of Finance.

The respected legislative analyst, Elizabeth Hill, isn't quite so dire in her predictions for next year. She sees a \$10 billion hole. Of that amount, \$4 billion represents the debt payments the state is obligated to make on \$20 billion it borrowed to balance previous budgets.

"While the past borrowing helped the state get from one fiscal year to the next, it created additional spending pressures to pay for past rather than current services," Hill wrote with customary understatement in her November state economic forecast.

She has made the same point for seven years running.

Borrowing is what Hill calls the budgetary "path of least resistance." Democrats don't want program cuts. Republicans don't want tax increases. So let's just borrow money from transportation or future tobacco settlement payments or sell some bonds that our kids get to retire and blow this whole mess off into the future.

Problem is, as former GOP lawmaker Ross Johnson is fond of saying, the sacred cows have come home to roost.

The reason budget shortfalls of the past three years have been smaller isn't because the state's fiscal condition is improving. The shortfalls were smaller because the state got more money than expected. Now revenues are down - down enough that it will eat right through a \$4.1 billion reserve account, one of the largest ever, by June.

Worth noting is that Hill's 2004 five-year economic forecast estimated state general fund spending at \$114 billion for the fiscal year that starts in July. Hill's most recent forecast uses the same number, which says something about the inadequacy of spending reductions made over the past five years.

As is her custom, Hill offers plenty of practical advice on how to bring spending in line with revenue - reduce the size of automatic cost-of-living increases in various state programs, deliver services better, get rid of tax credits, charge fees. And raise taxes.

Those are practical rather than political solutions. And usually political solutions trump sound policy. Here's the deal as Hill described it in an interview:

"Based on our latest forecast, the state has not brought current law spending and revenues into balance. Absent corrective action, the imbalance remains for each year through 2012-13."

McClintock favors restructuring the way the state delivers its services.

"We've bureaucratized, unionized and centralized the state's service delivery systems, and it doesn't work very well. It works with dogs - centralized rigid command and control. It works with insects. But it doesn't work with cats, and it doesn't work with human beings. It's the way we're wired."

Returning to the governor's 2004 credit card junkie analogy, most financial counselors worth their salt say the first step in ending credit dependency is to scale back your household budget.

What a novel approach.